

AMENDED IN SENATE MAY 10, 2005

AMENDED IN SENATE APRIL 20, 2005

**SENATE BILL**

**No. 754**

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**Introduced by Senator Poochigian**

February 22, 2005

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An act to amend Sections 16328, 16335, 16336, and 16338, and to add Sections 16336.4, 16336.5, 16336.6, and 16336.7 to, the Probate Code, relating to trusts.

LEGISLATIVE COUNSEL'S DIGEST

SB 754, as amended, Poochigian. Unitrust conversions.

Existing law governs proceedings for the administration of trusts.

This bill would authorize a trustee, unless prohibited by the governing instrument, to convert a trust into a unitrust, pursuant to specified procedures. The bill would permit the trustee to convert a trust into a unitrust without a court order if specified conditions and requirements are satisfied, the trustee gives written notice of the intent to convert in accordance with certain notice requirements, and no legally competent beneficiary objects to the proposed action in writing during a specified timeframe. The bill would give the trustee the power, after a trust is converted to a unitrust, to make regular distributions of trust income in accordance with specified provisions. The bill would also establish procedures by which a trustee may reconvert from a unitrust to a trust and change the distribution payout percentage of a unitrust. The bill would require a fiduciary administering a unitrust, reconverting a unitrust, or changing the percentage payout from a unitrust to administer the trust impartially. The bill would make other conforming changes to related provisions of law related to trust administration.

Vote: majority. Appropriation: no. Fiscal committee: no.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Section 16328 of the Probate Code is amended  
2 to read:

3 16328. “Net income” means the total receipts allocated to  
4 income during an accounting period minus the disbursements  
5 made from income during the accounting period, plus or minus  
6 transfers under this chapter to or from income during the  
7 accounting period. During any period in which the trust is being  
8 administered as a unitrust, either pursuant to the powers  
9 conferred by Sections 16336.4 to 16336.6, inclusive, or pursuant  
10 to the terms of the governing instrument, “net income” means the  
11 unitrust amount, if the unitrust amount is no less than 3 percent  
12 and no more than 5 percent of the fair market value of the trust  
13 assets, whether determined annually or averaged on a multiple  
14 year basis.

15 SEC. 2. Section 16335 of the Probate Code is amended to  
16 read:

17 16335. (a) In allocating receipts and disbursements to or  
18 between principal and income, and with respect to any other  
19 matter within the scope of this chapter, a fiduciary:

20 (1) Shall administer a trust or decedent’s estate in accordance  
21 with the trust or the will, even if there is a different provision in  
22 this chapter.

23 (2) May administer a trust or decedent’s estate by the exercise  
24 of a discretionary power of administration given to the fiduciary  
25 by the trust or the will, even if the exercise of the power produces  
26 a result different from a result required or permitted by this  
27 chapter, and no inference that the fiduciary has improperly  
28 exercised the discretion arises from the fact that the fiduciary has  
29 made an allocation contrary to a provision of this chapter.

30 (3) Shall administer a trust or decedent’s estate in accordance  
31 with this chapter if the trust or the will does not contain a  
32 different provision or does not give the fiduciary a discretionary  
33 power of administration.

34 (4) Shall add a receipt or charge a disbursement to principal to  
35 the extent that the trust or the will and this chapter do not provide

1 a rule for allocating the receipt or disbursement to or between  
2 principal and income.

3 (b) In exercising a discretionary power of administration  
4 regarding a matter within the scope of this chapter, whether  
5 granted by a trust, a will, or this chapter, including the trustee's  
6 power to adjust under subdivision (a) of Section 16336, and the  
7 trustee's power to convert into a unitrust or reconvert or change  
8 the unitrust payout percentage pursuant to Sections 16336.4 to  
9 16336.6, inclusive, the fiduciary shall administer the trust or  
10 decedent's estate impartially, except to the extent that the trust or  
11 the will expresses an intention that the fiduciary shall or may  
12 favor one or more of the beneficiaries. The exercise of discretion  
13 in accordance with this chapter is presumed to be fair and  
14 reasonable to all beneficiaries.

15 SEC. 3. Section 16336 of the Probate Code is amended to  
16 read:

17 16336. (a) Subject to subdivision (b), a trustee may make an  
18 adjustment between principal and income to the extent the trustee  
19 considers necessary if all of the following conditions are  
20 satisfied:

21 (1) The trustee invests and manages trust assets under the  
22 prudent investor rule.

23 (2) The trust describes the amount that shall or may be  
24 distributed to a beneficiary by referring to the trust's income.

25 (3) The trustee determines, after applying the rules in  
26 subdivision (a) of Section 16335, and considering any power the  
27 trustee may have under the trust to invade principal or  
28 accumulate income, that the trustee is unable to comply with  
29 subdivision (b) of Section 16335.

30 (b) A trustee may not make an adjustment between principal  
31 and income in any of the following circumstances:

32 (1) Where it would diminish the income interest in a trust (A)  
33 that requires all of the income to be paid at least annually to a  
34 spouse and (B) for which, if the trustee did not have the power to  
35 make the adjustment, an estate tax or gift tax marital deduction  
36 would be allowed, in whole or in part.

37 (2) Where it would reduce the actuarial value of the income  
38 interest in a trust to which a person transfers property with the  
39 intent to qualify for a gift tax exclusion.

1 (3) Where it would change the amount payable to a  
2 beneficiary as a fixed annuity or a fixed fraction of the value of  
3 the trust assets.

4 (4) Where it would be made from any amount that is  
5 permanently set aside for charitable purposes under a will or  
6 trust, unless both income and principal are so set aside.

7 (5) Where possessing or exercising the power to make an  
8 adjustment would cause an individual to be treated as the owner  
9 of all or part of the trust for income tax purposes, and the  
10 individual would not be treated as the owner if the trustee did not  
11 possess the power to make an adjustment.

12 (6) Where possessing or exercising the power to make an  
13 adjustment would cause all or part of the trust assets to be  
14 included for estate tax purposes in the estate of an individual who  
15 has the power to remove a trustee or appoint a trustee, or both,  
16 and the assets would not be included in the estate of the  
17 individual if the trustee did not possess the power to make an  
18 adjustment.

19 (7) Where the trustee is a beneficiary of the trust.

20 (8) During any period in which the trust is being administered  
21 as a unitrust pursuant to the trustee's exercise of the power to  
22 convert provided in Section 16336.4 or 16336.5.

23 (c) Notwithstanding Section 15620, if paragraph (5), (6), or (7)  
24 of subdivision (b) applies to a trustee and there is more than one  
25 trustee, a cotrustee to whom the provision does not apply may  
26 make the adjustment unless the exercise of the power by the  
27 remaining trustee or trustees is not permitted by the trust.

28 (d) A trustee may release the entire power conferred by  
29 subdivision (a) or may release only the power to adjust from  
30 income to principal or the power to adjust from principal to  
31 income in either of the following circumstances:

32 (1) If the trustee is uncertain about whether possessing or  
33 exercising the power will cause a result described in paragraphs  
34 (1) to (6), inclusive, of subdivision (b).

35 (2) If the trustee determines that possessing or exercising the  
36 power will or may deprive the trust of a tax benefit or impose a  
37 tax burden not described in subdivision (b).

38 (e) A release under subdivision (d) may be permanent or for a  
39 specified period, including a period measured by the life of an  
40 individual.

1 (f) A trust that limits the power of a trustee to make an  
2 adjustment between principal and income does not affect the  
3 application of this section unless it is clear from the trust that it is  
4 intended to deny the trustee the power of adjustment provided by  
5 subdivision (a).

6 (g) In deciding whether and to what extent to exercise the  
7 power to make adjustments under this section, the trustee may  
8 consider, but is not limited to, any of the following:

9 (1) The nature, purpose, and expected duration of the trust.

10 (2) The intent of the settlor.

11 (3) The identity and circumstances of the beneficiaries.

12 (4) The needs for liquidity, regularity of income, and  
13 preservation and appreciation of capital.

14 (5) The assets held in the trust; the extent to which they consist  
15 of financial assets, interests in closely held enterprises, tangible  
16 and intangible personal property, or real property; the extent to  
17 which an asset is used by a beneficiary; and whether an asset was  
18 purchased by the trustee or received from the settlor.

19 (6) The net amount allocated to income under other statutes  
20 and the increase or decrease in the value of the principal assets,  
21 which the trustee may estimate as to assets for which market  
22 values are not readily available.

23 (7) Whether and to what extent the trust gives the trustee the  
24 power to invade principal or accumulate income or prohibit the  
25 trustee from invading principal or accumulating income, and the  
26 extent to which the trustee has exercised a power from time to  
27 time to invade principal or accumulate income.

28 (8) The actual and anticipated effect of economic conditions  
29 on principal and income and effects of inflation and deflation.

30 (9) The anticipated tax consequences of an adjustment.

31 (h) Nothing in this section or in this chapter is intended to  
32 create or imply a duty to make an adjustment, and a trustee is not  
33 liable for not considering whether to make an adjustment or for  
34 choosing not to make an adjustment.

35 SEC. 4. Section 16336.4 is added to the Probate Code, to  
36 read:

37 16336.4. (a) Unless expressly prohibited by the governing  
38 instrument, a trustee may convert a trust into a unitrust, as  
39 described in this section. A trust that limits the power of the  
40 trustee to make an adjustment between principal and income or

1 modify the trust does not affect the application of this section  
2 unless it is clear from the governing instrument that it is intended  
3 to deny the trustee the power to convert into a unitrust.

4 (b) The trustee may convert a trust into a unitrust without a  
5 court order if all of the following apply:

6 (1) The conditions set forth in subdivision (a) of Section  
7 16336 are satisfied.

8 (2) The unitrust proposed by the trustee conforms to the  
9 provisions of subdivision (e).

10 (3) The trustee gives written notice of the trustee's intention to  
11 convert the trust into a unitrust and furnishes the information  
12 required by subdivision (c). The notice shall comply with the  
13 requirements of Chapter 5 (commencing with Section 16500),  
14 *including notice to a beneficiary who is a minor and to the*  
15 *minor's guardian, if any.*

16 (4) No legally competent beneficiary objects to the proposed  
17 action in a writing delivered to the trustee within the period  
18 prescribed by subdivision (d) of Section 16502 or a longer period  
19 as is specified in the notice described in subdivision (c).

20 (c) The notice described in paragraph (3) of subdivision (b)  
21 shall include a copy of Sections 16336.4 to 16336.7, inclusive,  
22 and all of the following additional information:

23 (1) A statement that the trust shall be administered in  
24 accordance with the provisions of subdivision (e) and the  
25 effective date of the conversion.

26 (2) A description of the method to be used for determining the  
27 fair market value of trust assets.

28 (3) The amount actually distributed to the income beneficiary  
29 during the previous accounting year of the trust.

30 (4) The amount that would have been distributed to the income  
31 beneficiary during the previous accounting year of the trust had  
32 the trustee's proposed changes been in effect during that entire  
33 year.

34 (5) A description of the discretionary decisions the trustee  
35 proposes to make as of the conversion date pursuant to  
36 subdivision (f).

37 (d) In deciding whether to exercise the power conferred by this  
38 section, a trustee may consider, among other things, the factors  
39 set forth in subdivision (g) of Section 16336.

1 (e) Except to the extent that the court orders otherwise or the  
2 parties agree otherwise pursuant to Section 16336.5 after a trust  
3 is converted to a unitrust, all of the following shall apply:

4 (1) The trustee shall make regular distributions in accordance  
5 with the governing instrument construed in accordance with the  
6 provisions of this section.

7 (2) The term “income” in the governing instrument shall mean  
8 an annual distribution, the unitrust amount, equal to 4 percent,  
9 which is the payout percentage, of the net fair market value of the  
10 trust’s assets, whether those assets would be considered income  
11 or principal under other provisions of this chapter, averaged over  
12 the lesser of: (A) the three preceding years, or (B) the period  
13 during which the trust has been in existence.

14 (3) During each accounting year of the trust following its  
15 conversion into a unitrust, the trustee shall, as early in the year as  
16 is practicable, furnish each income beneficiary with a statement  
17 describing the computation of the unitrust amount for that  
18 accounting year.

19 (4) The trustee shall determine the net fair market value of  
20 each asset held in the trust no less often than annually. However,  
21 the following property shall not be included in determining the  
22 unitrust amount:

23 (A) Any residential property or any tangible personal property  
24 that, as of the first business day of the current accounting year,  
25 one or more current beneficiaries of the trust have or have had  
26 the right to occupy, or have or have had the right to possess or  
27 control, other than in his or her capacity as trustee of the trust,  
28 which property shall be administered according to other  
29 provisions of this chapter as though no conversion to a unitrust  
30 had occurred.

31 (B) Any asset specifically devised to a beneficiary to the  
32 extent necessary, in the trustee’s reasonable judgment, to avoid a  
33 material risk of exhausting other trust assets prior to termination  
34 of the trust. All net income generated by a specifically devised  
35 asset excluded from the unitrust computation pursuant to this  
36 subdivision shall be accumulated or distributed by the trustee  
37 according to the rules otherwise applicable to that net income  
38 pursuant to other provisions of this chapter.

39 (C) Any asset while held in a testator’s estate or a terminating  
40 trust.

(5) The unitrust amount, as otherwise computed pursuant to this subdivision, shall be reduced proportionately for any material distribution made to accomplish a partial termination of the trust required by the governing instrument or made as a result of the exercise of a power of appointment or withdrawal, other than distributions of the unitrust amount, and shall be increased proportionately for the receipt of any material addition to the trust, other than a receipt that represents a return on investment, during the period considered in paragraph (2) in computing the unitrust amount. For the purpose of this paragraph, a distribution or an addition shall be “material” if the net value of the distribution or addition, when combined with all prior distributions made or additions received during the same accounting year, exceeds 10 percent of the value of the assets used to compute the unitrust amount as of the most recent prior valuation date. The trustee may, in the reasonable exercise of his or her discretion, adjust the unitrust amount pursuant to this subdivision even if the distributions or additions are not sufficient to meet the definition of materiality set forth in the preceding sentence.

(6) In the case of a short year in which a beneficiary’s right to payments commences or ceases, the trustee shall prorate the unitrust amount on a daily basis.

(7) Unless otherwise provided by the governing instrument or determined by the trustee, the unitrust amount shall be considered paid in the following order from the following sources:

(A) From the net taxable income, determined as if the trust were other than a unitrust.

(B) From net realized short-term capital gains.

(C) From net realized long-term capital gains.

(D) From tax-exempt and other income.

(E) From principal of the trust.

(8) Expenses that would be deducted from income if the trust were not a unitrust may not be deducted from the unitrust amount.

(f) The trustee shall determine, in the trustee’s discretion, all of the following matters relating to administration of a unitrust created pursuant to this section:

(1) The effective date of a conversion to a unitrust.

1 (2) The frequency of payments in satisfaction of the unitrust  
2 amount.

3 (3) Whether to value the trust's assets annually or more  
4 frequently.

5 (4) What valuation dates to use.

6 (5) How to value nonliquid assets.

7 (6) The characterization of the unitrust payout for income tax  
8 reporting purposes. However, the trustee's characterization shall  
9 be consistent.

10 (7) Any other matters necessary for the proper functioning of  
11 the unitrust.

12 (g) A conversion into a unitrust does not affect a provision in  
13 the governing instrument directing or authorizing the trustee to  
14 distribute principal or authorizing the exercise of a power of  
15 appointment over or withdrawal of all or a portion of the  
16 principal.

17 (h) A trustee may not convert a trust into a unitrust in any of  
18 the following circumstances:

19 (1) If payment of the unitrust amount would change the  
20 amount payable to a beneficiary as a fixed annuity or a fixed  
21 fraction of the value of the trust assets.

22 (2) If the unitrust distribution would be made from any amount  
23 that is permanently set aside for charitable purposes under the  
24 governing instrument and for which a federal estate or gift tax  
25 deduction has been taken, unless both income and principal are  
26 set aside.

27 (3) If possessing or exercising the power to convert would  
28 cause an individual to be treated as the owner of all or part of the  
29 trust for federal income tax purposes, and the individual would  
30 not be treated as the owner if the trustee did not possess the  
31 power to convert.

32 (4) If possessing or exercising the power to convert would  
33 cause all or part of the trust assets to be subject to federal estate  
34 or gift tax with respect to an individual, and the assets would not  
35 be subject to federal estate or gift tax with respect to the  
36 individual if the trustee did not possess the power to convert.

37 (5) If the conversion would result in the disallowance of a  
38 federal estate tax or gift tax marital deduction that would be  
39 allowed if the trustee did not have the power to convert.

(i) If paragraph (3) or (4) of subdivision (h) applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may convert the trust unless the exercise of the power by the remaining trustee or trustees is prohibited by the governing instrument. If paragraph (3) or (4) of subdivision (h) applies to all of the trustees, the court may order the conversion as provided in subdivision (b) of Section 16336.5.

(j) A trustee may release the power conferred by this section to convert to a unitrust if (1) the trustee is uncertain about whether possessing or exercising the power will cause a result described in paragraph (3), (4), or (5) of subdivision (h), or (2) the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subdivision (h). The release may be permanent or for a specified period, including a period measured by the life of an individual.

SEC. 5. Section 16336.5 is added to the Probate Code, to read:

16336.5. (a) The trustee may convert a trust into a unitrust upon terms other than those set forth in subdivision (e) of Section 16336.4, without court order, if all of the following apply:

(1) The conditions set forth in subdivision (a) of Section 16336 are satisfied.

(2) The trustee gives written notice of the trustee's intention to convert the trust into a unitrust and furnishes the information required by subdivision (c) of Section 16336.4. The notice shall comply with the requirements of Chapter 5 (commencing with Section 16500), *including notice to a beneficiary who is a minor and to the minor's guardian, if any.*

(3) The payout percentage to be adopted is at least 3 percent and no greater than 5 percent.

(4) All legally competent beneficiaries entitled to notice under Section 16501 consent in writing to the proposed action after having been furnished with the notice described in subdivision (c) of Section 16336.4.

(b) The court may order the conversion of a trust into a unitrust as provided in this subdivision.

(1) (A) The trustee may petition the court to approve the conversion to a unitrust for any one of the following reasons:

1 (i) A beneficiary timely objects to a proposed conversion to a  
2 unitrust.

3 (ii) The trustee proposes to make the conversion upon terms  
4 other than those described in subdivision (e) of Section 16336.4.

5 (iii) Paragraph (3) or (4) of subdivision (h) of Section 16336.4  
6 applies to all currently acting trustees.

7 (iv) For any other reason other than those set forth in  
8 subparagraphs (A) and (B), the trustee determines, in its  
9 discretion, that a petition is advisable.

10 (B) In no event, however, may the court authorize conversion  
11 to a unitrust with a payout percentage of less than 3 percent or  
12 greater than 5 percent of the fair market value of the trust assets.

13 (2) A beneficiary may petition the court to order the  
14 conversion.

15 (3) The court shall approve the conversion proposed by the  
16 trustee or direct the conversion requested by the beneficiary if the  
17 conditions set forth in subdivision (a) of Section 16336 are  
18 satisfied and the court concludes that conversion of the trust on  
19 the terms proposed will enable the trustee to better comply with  
20 the provisions of subdivision (b) of Section 16335.

21 (4) In deciding whether to approve a proposed conversion or  
22 direct a requested conversion, the court may consider, among  
23 other factors, those described in subdivision (g) of Section  
24 16336.

25 SEC. 6. Section 16336.6 is added to the Probate Code, to  
26 read:

27 16336.6. Unless expressly prohibited by the governing  
28 instrument, a trustee may reconvert the trust from a unitrust or  
29 change the payout percentage of a unitrust.

30 (a) The trustee may make the reconversion or change in  
31 payout percentage without a court order if all of the following  
32 conditions are satisfied:

33 (1) At least three years have elapsed since the most recent  
34 conversion to a unitrust.

35 (2) The trustee determines that reconversion or change in  
36 payout percentage would enable the trustee to better comply with  
37 the provisions of subdivision (b) of Section 16335.

38 (3) In the case of a proposed reconversion, the conditions set  
39 forth in paragraphs (4) to (6), inclusive, of subdivision (b) of  
40 Section 16336.4 have been satisfied and the trustee gives written

1 notice of the trustee's intention to reconvert the trust. The notice  
2 shall comply with the requirements of Chapter 5 (commencing  
3 with Section 16500).

4 (4) In the case of a proposed change in payout percentage, the  
5 conditions set forth in paragraphs (3) to (6), inclusive, of  
6 subdivision (a) of Section 16336.5 have been satisfied and the  
7 trustee gives written notice stating the new payout percentage  
8 that the trustee proposes to adopt. The notice shall comply with  
9 the requirements of Chapter 5 (commencing with Section 16500).

10 (b) The trustee may make the reconversion or change in  
11 payout percentage at any time pursuant to court order provided  
12 that: (1) the court determines that reconversion or change in  
13 payout percentage will enable the trustee to better comply with  
14 the provisions of subdivision (b) of Section 16335, and (2) in the  
15 case of a change in payout percentage, the new payout  
16 percentage is at least 3 percent and no greater than 5 percent. The  
17 court may enter an order pursuant to this subdivision upon the  
18 petition of the trustee or any beneficiary.

19 SEC. 7. Section 16336.7 is added to the Probate Code, to  
20 read:

21 16336.7. (a) Sections 16336.4 to 16336.6, inclusive, shall not  
22 impose any duty on the trustee to convert or reconvert a trust or  
23 to consider a conversion or reconversion.

24 (b) Subdivision (b) of Section 16503 applies to all actions  
25 pursuant to Sections 16336.4 to 16336.6, inclusive, for which  
26 notice of proposed action is given in compliance with Chapter 5  
27 (commencing with Section 16500), *including notice to a*  
28 *beneficiary who is a minor and to the minor's guardian, if any.*

29 SEC. 8. Section 16338 of the Probate Code is amended to  
30 read:

31 16338. In a proceeding with respect to a trustee's exercise or  
32 nonexercise of the power to make an adjustment under Section  
33 16336, the sole remedy is to direct, deny, or revise an adjustment  
34 between principal and income. In a proceeding with respect to a  
35 trustee's exercise or nonexercise of a power conferred by  
36 Sections 16336.4 to 16336.6, inclusive, the sole remedy is to  
37 obtain an order directing the trustee to convert the trust to a  
38 unitrust, to reconvert from a unitrust, to change the distribution  
39 percentage, or to order any administrative procedures the court

- 1 determines to be necessary or helpful for the proper functioning
- 2 of the trust.

O